Think again

Indirect Tax

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Angela Lang-Horgan examines new jurisdiction which will impact on the VAT treatment of chain transactions between the UK and Germany

On February 25th the highest German tax court, the Bundesfinanzhof (BFH), decided on the VAT implications of an EC chain transaction involving the UK (XI R 30/13). Now you might think: Who cares what a court in another country says! Well, bearing in mind that Germany is the second most important trade partner overall for the UK after the US and that, according to the German Foreign Office, the imports and exports between the two countries of goods alone amounted to £96 billion in 2014 you might want to think again.

The Case XI R 30/13

At first glance, the case seems to be rather simple and will probably happen numerous times every day. But this is exactly what constitutes its dangerously contagious potential. A German company (A) sold cars to a British company (B) which in turn sold it to another British company (C). A freight forwarder instructed and paid by C picked up the vehicles in Germany and brought them to the UK. Both facts could be documented. All three companies used their national VAT Identification Numbers. A treated the delivery to B as a zero-rated EC supply, B charged British VAT to C. Everything seemed to be fine until the German tax office (Finanzamt, FA) in charge of A made a VAT inspection. The FA argued that the EC supply took place between B and C as C had picked up the goods. This assessment of the VAT situation would have, maybe incomprehensible for a pragmatic British mind, likely gone undisputed in the decades before 2010. However, then the European Court of Justice started to gradually change the views of the German courts on EC chain transactions. The German VAT landscape is now in turmoil.

The German Handling of EC chain supplies

Germany (and also its “VAT twin” Austria) seems to have always been “the odd one out” when it comes to the VAT treatment of EC chain transactions. With a specific set of rules it differentiates between so called “ruhende Lieferungen” (roughly: local deliveries) and “bewegte Lieferungen” (roughly: transport deliveries) with a deeming rule for the allocation of the EC supply to one of the deliveries where a supplier in the middle of the chain transports or sends the goods. The ultimately decisive criterion was the instruction of the freight forwarder. In practice however, the deficiencies of this tool set were apparent. For instance, the role of the INCOTERMS, of immense importance in a real life business relationship, was unclear leaving THINK AGAIN supply chain managers in frustrated confusion. The rigidity of the deeming rule mentioned above also led and leads to clashes with other VAT jurisdictions. Further, as Germany does not have a unified “HMRC” but is split into local tax offices, the VAT treatment of a specific EC chain transaction could be seen differently by each of the tax offices in charge for each of the participants in the supply chain. This could result in stand-offs between tax offices and damage to the companies stuck in it.

Background of the Case

The British-German case discussed here (XI R 30/13) has been decided on the same day and essentially relying on the same grounds as XI R 15/14. The latter judgement puts to an end the case Vogtländische Straβen-, Tief- und Rohrleitungsbau GmbH Rodewisch v Finanzamt Plauen (VSTR) as it was then named when the ECJ decided about it on 27.12.2012 (C-587/10). Therefore, the cases XI R 30/13 (British-German case) and XI R 15/14 (VSTR) give the BFH’s interpretation of the ECJ’s guidelines on EC chain transactions. The wording especially of XI R 15/14 (VSTR) indicates strongly that the opinion of the BFH is to be taken as a sort of obiter dictum and meant as benchmark for the foreseeable future of VAT jurisprudence on EC chain transactions.

In XI R 15/14 (VSTR) and XI R 11/09 (the first referral back from the ECJ to the BFH of the case VSTR) the BFH also distances itself strongly from an earlier judgement of the same court (V R 3/10, 11.8.2011), but decided by a different (the 5th) chamber: For the purpose of allocating the EC supply to one of the supplies in the chain the 11th chamber says that it is irrelevant whether before the transport of the goods commenced the first customer disclosed to the first supplier that the goods are subsequently sold. It was the opinion of the 5th chamber of the BFH that the first

customer had a choice: If he did not disclose the subsequent sale, the delivery of the goods from the first supplier to him (the first customer) was to be treated as EC supply. Otherwise the EC supply occurred between him and the second customer. The decision of the 5th chamber had been welcomed by many as a way out of a dilemma the first customer often faced: He did not want to reveal his customer to the first supplier in order to protect his business opportunities. Also, the first customer often simply did not know who else was involved in the supply chain. The jurisdiction of the 5th chamber seemed to be a pragmatic way out of the Ifs and Buts of the VAT treatment of EC chain transactions. Well, in a mighty act XI R 15/14 has reminded the Germans of their virtues of thoroughness and faithfulness to Europe.

The Outcome

Although the BFH could not finally decide XI R 30/13 (the British-German case) due to missing facts, it provided the First Tier Tribunal (Finanzgericht, FG) with a strong framework of guidelines as to how the case had to be resolved. The Court emphasizes that “all circumstances of the individual case” had to be examined carefully. It states that

- it is not alone decisive who transported or sent the goods (i.e. instructed the freight forwarder). This goes expressively against the opinion of the tax authorities as outlined in s 3.14 (7) et sqq. VAT manual (Umsatzsteueranwendungserlass, UStAE).
- it is instead crucial to determine [similarly to the US-American approach in sales taxes] when the power to dispose of the goods has been transferred: If it has been transferred from A to B on German soil then the EC supply takes place between those two parties; if C however received the power to dispose of the goods from B before they were shipped to the UK then B makes the EC supply to C.

The latter situation is especially problematic for the two British companies: B might be forced to VAT register in Germany (retrospectively) in order to get a refund of the German VAT charged by A to him, but could also be obliged to charge British VAT to C, leaving C with the challenge to declare the acquisition of the goods as well as

claim the British input VAT at the same time.

And what does this mean for your clients?

For now, the German VAT world on EC chain transactions is split. The opinion of the German tax authorities as outlined in s 3.14 (7) et sqq. UStAE is currently unchanged. It is unclear, if or how they will amend their guidelines. I think however, that assessing an EC chain transaction merely by looking at the party who has instructed the freight forwarder or to rely on the disclosure/ nondisclosure of the second supplier’s customer is not a safe bet any more. It is highly advisable to check upfront and, if necessary, amend the contractual details together with shipping arrangements and INCOTERMS carefully in order to allow a watertight determination as to when and where the power to dispose of the goods will be transferred.

Additionally, there is still a whole host of other obligations under German Laws to consider: The proofs of dispatch (a saga on its own) (Belegnachweis) and valid documentation of the EC supply in the books (Buchnachweis) are essential formalities in order to be allowed zero-rating under German VAT Laws.

Outlook

All these endless discussions about EC chain supplies in the EU really begs the question why we have clung onto this VAT model since 1993 and put up with its deficiencies. From a VAT perspective, it might be more advisable to companies with more complex supply chains to simply stay out of the EU and enjoy the relatively plain VAT mechanisms of ex- and imports. At least that was the rather surprising outcome of a case study I once conducted for a multinational client who was seeking the best location for his distribution hub for worldwide deliveries. Let’s think again!